

ARE HOSPITAL/BOARD MEMBER CONFLICTS OF INTEREST ILLEGAL?

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Spoiler Alert!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!!

The answer is no.

Therefore, we should not be afraid to talk about conflicts of interest at the Board or Committee level.

Just deal with them!

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What We Will Cover Today:

Conflicts of Interest:

- Applicable Legal and Regulatory Considerations
- Observations from Recent High-Profile Cases and Studies
- Practical Approaches to Managing Conflicts of Interest

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What Do We Mean?

Conflict of Interest

- IRS: "Arises when a person in a position of authority over an organization, such as a director, officer or manager, may benefit personally from a decision he or she could make"
- On-Line Business Dictionary: "a situation that has the potential to undermine the impartiality of a person because of the possibility of a clash between the person's self-interest and professional interest or public interest"

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What Do We Mean?

- Nebraska Nonprofit Corporation Act (Neb. Rev. Stat. section 21-1987):
 - Conflict of Interest Transaction: when a director has a direct or indirect interest.
- Iowa Nonprofit Corporation Act – similar definition (Iowa Code section 504.833)

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Why Do Conflicts Matter?

- Pose Potential Harm to Consumer, Patients, Research Subjects, Others
- Can Undermine Maximization of Corporate Opportunity
- Proper Management of Conflicts:
 - Important to Legal and Regulatory Compliance
 - Integral Part of Organizational Integrity
 - Promotes transparency and accountability
 - Protects organization reputation

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How Does a Conflict Arise?

- Ownership or financial interests in business counter-parties (suppliers, vendors, etc.)
- Compensation relationship with organization
- Board membership on other boards
- Academia/health industry collaborations
 - Research Services Agreements
 - Faculty consulting arrangements with industry
 - Faculty ownership of invention/technology
 - Faculty as Principal/Participating Investigator (e.g., clinical trials of investigational drugs or devices; grant-funded research, etc.)

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What are the Responsibilities of Hospital Board Members?

- General Corporate Law: Duties of Corporate Board Members
- IRS Directives for Entities Tax Exempt under Federal Law
- Medicare Conditions of Participation for Hospitals
- State Laws Governing Licensed Hospitals

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General Corporate Law; Duties of Directors

- Fiduciary Duty
 - Directors are fiduciaries.
 - Must act in best interest of corporation.
 - Board membership is not to represent any other party's interests on the board.
 - In the case of nonprofit corporations, directors arguably act on behalf of the state's Attorney General, who is charged with protecting the public's interest in the assets that enjoy nonprofit and tax exempt status

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At the Core: Fiduciary Duties of Directors and Officers

What are fiduciary duties?

- **Duty of Care**

- Requires officers and directors to carry out their responsibilities in good faith and with that degree of diligence, care and skill which ordinarily prudent persons would exercise under similar circumstances in like positions
- Requires informed, good faith decisions intended to further the organization's purposes

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At the Core: Fiduciary Duties of Directors and Officers (cont'd)

What are fiduciary duties?

- **Duty of Loyalty**

- Requires officers and directors to act in good faith and in a manner that is reasonably believed to be in accordance with the best interests of the corporation
- Requires directors and officers to faithfully pursue the interests of the corporation and its nonprofit purpose rather than their own interests or the interests of another person or organization

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At the Core: Fiduciary Duties of Directors and Officers (cont'd)

What are fiduciary duties?

- **Duty of Obedience**

- Requires that officers and directors effectively carry out the purposes and mission of the organization
- Requires that officers and directors cause the organization to be compliant with the law

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Directors-General Standards

- What Directors are **NOT**
 - Representatives of, or advocates for, other groups or organizations.
 - Even if holding an ex officio position. E.g., Physician who holds ex-officio position on Board by virtue of Medical Staff Presidency does not represent physician interests.
 - Public interest is served by protecting and enhancing THIS entity and ITS mission
 - Insurers of entity's welfare. Duty is to exercise due care and loyalty, not to guarantee results
 - Administrative Officers
 - Individual directors have NO authority to act individually on behalf of the corporation - unless specifically delegated by Board
 - Board collectively delegates day-to-day management.
 - Duty to OVERSEE should not be confused with duty to MICROMANAGE

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Typical Breaches of Fiduciary Duties

- Failure to regularly attend meetings
- Failure to read information presented - (Bylaws - audits - annual reports - monthly reports)
- Failure to oversee delegated work of management
- Failure to oversee financial transactions - (purchases/sales - investments - expenditures - reporting/ payment of payroll and other taxes - compliance with limitation on tax-exempt nonprofits)
- **Failure to disclose/recuse from conflicts of interest**
- Failure to ask questions, require accountability, and actively participate in Board functions

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State Law on Conflicts of Interest

- Nebraska:
 - A conflict of interest transaction is not voidable or the basis for imposing liability on the director if it was fair at the time it was entered into or is approved as follows:
 1. By vote of Board/Committee if the following are known in advance:
 - Material facts
 - Interest of director in the transaction
 2. Directors approving transaction reasonably believe in good faith the transaction is fair to the corporation.

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State Law on Conflicts of Interest

- Nebraska:
 - Alternative to Board/Committee approval of COI Transaction
 - Attorney General or District Court approval of transaction
 - Either before or after it is consummated
 - Indirect COI exists if
 1. Director has a material interest in or is a general partner in an entity that is a party to the transaction
 2. Another entity of which the director is a director, officer, trustee is a party to the transaction.

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State Law on Conflicts of Interest

- Iowa:
 - Same provisions on COI as described in Nebraska law, except:
 - There is no alternative of the Attorney General or the District Court approving a COI transaction.

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Hospitals as Tax-Exempt Organizations

- Section 501(c)(3):
 - Organized exclusively for charitable purposes
 - Operated for charitable purposes
 - Annual information return (Form 990) documents activities

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Hospitals as Tax-Exempt Organizations

- Section 501(c)(3) Limitations
 - No inurement – no individual “profit” stakes
 - No excess private benefit
 - No substantial lobbying activities
 - Absolutely no intervening in political campaigns – direct or indirect
 - Limited unrelated activity or unrelated business income
- Intermediate sanctions for excess benefits

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Applicable Legal and Regulatory Considerations: IRS Guidance

- Conflict of Interest Policy not required in order to qualify entity as a charitable organization
- IRS 1997 Community Board and Conflict of Interest Policy
- Form 1023 Instructions-Appendix A-Sample Conflicts Policy

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Applicable Legal and Regulatory Considerations: IRS Guidance

- Disclosure of process for dealing with conflicts required on Form 990
 - Number of independent directors
 - Core Form-Part VI – Governance
 - Schedule H-Hospitals-Part IV-MCs and JVs
 - Schedule L-Transactions with Interested Persons
 - Schedule O-Supplemental Information
 - Schedule R-Related Organizations

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Applicable Legal and Regulatory Considerations: IRS Guidance

- IRS Intermediate Sanctions Regulations
 - Excise tax on "excess benefits" to "disqualified persons"
 - Includes directors and others in position to exercise substantial influence
 - Rebuttable presumption of reasonableness
 - Elements parallel typical conflicts practice (review of arrangement by independent board or committee; use of market data; documented in meeting minutes)

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IRS Governance Guidance

- IRS :
A well governed charity is more likely to
 - obey the tax laws,
 - safeguard charitable assets, and
 - serve charitable intereststhan one with poor or lax governance

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IRS Governance Guidance

- IRS instructions to field agents –
What to look for in Board oversight:
1. Stewardship – is the governing body managing on behalf of the general public?
 2. Mission focus – do the organization's resources remain focused on its mission?
 3. Oversight – responsible to review and approve the mission, budget, key transactions and compensation

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IRS Governance Guidance

4. Fulfillment of obligations – responsible to see that the organization fulfills its obligations to the law, donors, employees and public
5. Asset protection – protect organizational assets and ensure their charitable use
6. Vision – set the vision and strategic direction of the organization
7. Hire a competent executive – governing bodies are not expected to manage the day-to-day activities of the organization

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Independent Directors

- IRS Form 990 inquires as to percentage of independent directors
 - Definition:
 - Not paid as employee or officer
 - Not more than \$10,000 as independent contractor
 - Nothing reportable on Schedule L (single transaction exceeding greater of \$10,000 or 1% of revenues, all transactions aggregate over \$100K, compensation to family member over \$10,000)
- IRS guidance: Majority of directors should be independent

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Review of Form 990; Information Return of Tax Exempt Entity

- Form 990 asks:
 - Whether copy was provided to the full board prior to filing
 - For a description of the process used to review the 990

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Applicable Legal and Regulatory Considerations: Recipients of NIH-PHS Funds

- 42 CFR Part 50, Subpart F – *Responsibility of Applicants for Promoting Objectivity in Research for which PHS Funding is Sought*
- Applies to:
 - Any institution seeking PHS funding
 - Any investigator who participates (or plans to participate) in PHS-funded research
 - Includes investigator's spouse and dependent children
 - Applies to subinvestigators and subawards

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Applicable Statutes and Regulations: Healthcare Industry Specific

- Federal Anti-Kickback Law [42 U.S.C. § 1320s-7b(b)]
 - Illegal to offer or pay remuneration to induce or reward referrals of items or services that are reimbursable under Federal health care programs
 - Can impose criminal penalties, fines and administrative sanctions
- Physician Self-Referral Law (the "Stark" Law) [42 U.S.C. § 1395nn]
 - Prohibits physicians from referring patients for "designated health services" to entities with which the physician or an immediate family member has a relationship, unless an exception applies
 - Repayment of reimbursement amounts previously paid, fines and program exclusion

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Applicable Statutes and Regulations: Healthcare Industry Specific

- Physician Payments Sunshine Act [PPACA § 6002; 42 C.F.R. Part 403]
 - Requires medical product manufacturers to disclose to CMS any payments or other transfers of value made to physicians and teaching hospitals. Also requires GPOs to disclose whether they have physician ownership
 - Disclosure data is publicly available:
<https://www.cms.gov/openpayments/>

Each is rooted in concern that individual financial interest may inappropriately influence clinical practice in some way (whether choice of drug, choice of device, type of service, site of service, etc.)

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Memorial Sloan Kettering

- The *New York Times* and *ProPublica*: joint publication of articles beginning September 2018
- Reported concerns:
 - Failure by Dr. Jose Baselga (MSK's long-time CMO) to disclose financial relationships with a number of industry companies (including Roche and Bristol-Meyers Squibb), one being receipt of remuneration reportedly exceeding \$3 million from Roche alone
 - Equity ownership by MSK senior leaders in Paige.AI, a start-up A/I company that was founded by an MSK Board member, the chair of Pathology and the head of an MSK research laboratory
 - An exclusive licensing arrangement to license MSK's tissue library (said to include more than 25 million samples) to Paige.AI

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Memorial Sloan Kettering

Events Timeline:

- September 2018: CMO, Dr. Baselga, resigned from MSK
- October 2018: CEO, Dr. Craig Thompson, resigned from the Boards of Merck and Charles River Laboratories
- January 2019: MSK revised conflicts policy to prohibit top executives from serving on the boards of drug and health care companies
- April 2019: MSK adopted further revised policies after independent investigation found:
 - Officials frequently violated or skirted MSK's conflicts policy
 - Hospital leaders' ties to industry were reviewed on an *ad hoc* basis; and
 - Researchers frequently did not know that senior executives had personal ownership interests that could be affected by research outcomes

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UMMS – Hospital System Board Conflicts of Interest

Events Timeline

- 1984: University of Maryland Medical System (UMMS) parent company was created when state-owned University Hospital became a private, nonprofit organization; continued to receive state funding
- Voting members of UMMS Board were appointed by Maryland governor, Board included mayor, current and former public officials, and 6 ex-officio members who were university system and hospital officials
- March 13, 2019: *Baltimore Sun* published info that 9 of 30 members of UMMS Board, including the mayor, had business deals the System worth hundreds of thousands of dollars each; many were no-bid deals
- State Sen. Jill Carter sponsored legislation to make it illegal for board members to profit from contracts with hospitals they govern

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UMMS – Hospital System Board Conflicts of Interest (cont'd)

The Response

- UMMS spokesperson stated that contracts were legal and fully disclosed (contract revenue > \$10K for a director must be disclosed).
- UMMS had consistently enforced conflict policy and complied with all state financial disclosure requirements for hospitals.
- Mayor stated that directors do not vote on their own contracts
- Financial disclosures reported to state Health Services Cost Review Commission
- Transactions with Interested Persons required to be disclosed on Form 990, Schedule L
- "What we've done is nothing wrong . . ."

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UMMS – Hospital System Board Conflicts of Interest (cont'd)

Identified interested director contract:

- Multimillion dollar insurance policies
- Multimillion dollar banking arrangements
- Consulting services contracts worth > \$150K annually
- Ambulance company services contract worth > \$100K annually
- Technology company services contract worth > \$100K each for director and son
- Physician practice generated > \$300K in a year through 3 contracts
- Civil engineering services contract worth > \$100K
- Pest control services contract worth > \$160K

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UMMS – Hospital System Board Conflicts of Interest (cont'd)

Identified interested director contract:

- Most prominent arrangement was with Baltimore mayor. She self-produced children's books, the "Healthy Holly" series, and sold them to UMMS and others for distribution to school children



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UMMS – Hospital System Board Conflicts of Interest (cont'd)

The Consequences

- Many directors resigned
- Mayor also resigned as Mayor of Baltimore
- UMMS President and CEO resigned
- Maryland governor planned to replace entire board
- Carter Bill passed, applied restrictions on director contracts
- Outside consultant to review legality of contracts, governance practices
- State audit ordered
- Federal, state and city investigations aplenty
- Acting CEO froze exec bonuses pending review of insider contracts

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UMMS – Hospital System Board Conflicts of Interest (cont'd)

- What did the board do wrong?
 - Compliance with conflicts policy?
 - Full disclosure and reporting?
 - Failure to seek other options?
 - Failure to monitor contract fulfillment?
 - Avoiding the appearance of impropriety or self interest?
- The Front Page Test

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Omaha World-Herald

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BELLEVUE LAND ACQUISITION

Council member casts an improper vote

Kathy Welch, a real estate agent, would get commission on deal; she's expected to abstain from new vote today

By RICHIE RISTOW
WORLD-HERALD STAFF WRITER

After presenting a real estate deal to the Bellevue City Council in mid-September, Kathy Welch — a real estate agent and sitting councilwoman — then voted in favor of the deal, for which she would receive a commission.

Public officials can't have a financial interest in contracts with their governing body, according to the Nebraska Accountability and Disclosure Commission, which would suggest that her vote was in violation of state law.

The council plans to take a new vote on the deal at its Tuesday meeting, where Welch is expected

to disclose her conflict and abstain from voting.

Welch declined to comment Monday and directed questions to Jim Ristow, Bellevue's city administrator, who is not an elected official.

"She should have recused herself from the vote, and she didn't," Ristow said.

Welch's vote came on an \$808,000 purchase agreement for 44 acres of land east of 36th Street

See Welch: Page 2

Holt County supervisor told not to vote or lobby

Board member agreed to allow pipeline to cross his land, said he would receive \$49,000 from TC Energy.

Holt County supervisor offered \$49,000 'cooperation bonus' is told not to vote or lobby on pipeline

Pipeline: Supervisor offered 'cooperation bonus'


Continued from Page 1

Teller's association with TC Energy has raised controversy previously. This summer he disclosed that he had been offered a \$49,000 "cooperation bonus" from TC Energy in a guarantee for his help in getting the pipeline built. Teller said it wasn't a bribe, but it is a contribution for TC Energy said the bonus was being offered to a landowner who had already signed right of way agreements and who have political ties with the company for additional property if it is needed during construction.

Opponents of the pipeline said the bonus was a bribe, and if it was not, it was a contribution. Teller said he was not a lobbyist and he was not a politician. He said he was not a lobbyist and he was not a politician. He said he was not a lobbyist and he was not a politician.

Anti-pipeline Activists, County Supervisor Differ On Whether \$49,000 Payment Was Bribe

By Paul Hammett and Martha Stockard/World Herald Bureau Aug 23, 2019



Holt County Board of Supervisors Chairman William Teller

2014 IRS Data

- 46% of > 2,300 nonprofit hospitals had at least one board member or officer with business ties to the hospital (directly or through a relative)
- 7% of all other nonprofit organizations had such business ties

2014 IRS Data

- At more than 270 nonprofit hospitals, the arrangements top \$1M each.
- Many of the largest deals involved hospitals and medical companies that had common board members.
- But many instances of multimillion dollar contracts with companies owned by trustees: advertising and construction.

Avera McKennan Hospital and Univ. Health Center; Sioux Falls SD

- In 2014, Avera paid \$20.9M to Journey Group (JG), a construction company tied to one of its Board members.
- Avera Board member David Fleck was Chairman of JG until 2012. He sold his equity position, but declined to say whether JG still paid him in 2014.
- Avera Health included 545-bed hospital, five rural hospitals and dozens of clinics.
- This 2014 payout followed years of similarly large deals with the same company.

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THE WALL STREET JOURNAL.

BUSINESS

Nonprofit Hospitals' Business Relationships Can Present Conflicts

While not necessarily improper, administrators and board members might be forced to choose between what's best for the hospital and what's best for their private interests



Dignity Health California Hospital Medical Center in downtown Los Angeles. Nathan Dean, son of Dignity CEO Lloyd Dean, landed a multimillion-dollar marketing contract in 2011 to create an online market for Dignity's branded goods and to produce those items. PHOTO: RINGO CHIU/ZUMA PRESS

In a Web of Conflicts, Trust Between the Public
and Hospital Trustees Remains Paramount

Dignity Health; LA, CA

- CEO's son's company (he owned 51%) landed a contract in 2011 to create an online market for Dignity's branded goods and to produce them (e.g., lapel pins and badge clips)
- The 39-hospital chain paid the son's company \$3.8M over 2 years, and the contract was renewed in 2014.
- CEO defended saying Dignity followed an open bidding process, but would not say whether his son's company was the low bidder.

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SoutheastHEALTH; Cape Girardeau, MO

- Frank Kinder, co-owner of an advertising agency joined the local hospital board in 2009.
- Started with a small branding project.
- Hospital paid his agency \$8.2M between 2010 and 2014.
- Hospital was his 2nd biggest client.
- Recused from discussion and voting at first.
- Declined Hospital business for 2015.

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Drastic Measures – No Conflicts Allowed

- Licking Memorial Health Systems, of Newark, OH, banned business contracts with board members.
- Started in early 2000s, when three board members had hospital business. The banker, lawyer and real estate developer all decided to resign when given the choice
- Objective: make sure "our community had confidence that our board members were truly here as volunteers."

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WSJ: Hospitals Do Business
with Board Members at 6X
the Rate of Other Nonprofits

Conflict of Interest Policy - Elements

- Annual Disclosure of Conflicts
 - Board members and officers complete a survey and certify that they have re-read the COI Policy
 - COI Committee of Board reviews reported COIs,
 - and reports them to the entire Board

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Conflict of Interest Policy - Elements

- Board consideration of COI transaction
 - Declare the COI prior to any discussion of the transaction at any committee or Board meeting
 - Describe actions to mitigate COI (e.g., RFP, bid process, independent valuation consultant)
 - Recusal of all conflicted Board members for discussion and vote

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Duality of Interest

- One board member sits on two boards of corporations jointly engaged in transactions.
- Is this any less a conflict of interest because the financial benefits go to a corporation and not into the board member's pocket?

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Managing Conflicts of Interest

- Generally, no legal prohibition against entering into a transaction or a relationship when a conflict is present; that's what the COI process is for
- But not all legal transactions are appropriate
- Take disclosure seriously and address conflicts (and appearances of conflicts)-whose job is this?
- Don't forget about the COI policy after the annual disclosure process has been completed
- Respect confidentiality

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Managing Conflicts of Interest

- Follow the process established by COI Policy
- Conduct appropriate due diligence (e.g., issue an RFP; solicit proposals from non-conflicted parties)
- Adopt a conflict management plan
- Consider dualities of interest at the time of board appointment
- Use "front page gut check"—consider public perceptions if procedures aren't followed or fail

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Elements of Conflict Management Plan

- How broadly is policy applied? Who is included?
- Disclosure of the conflict (public as necessary)
- Review and approval by the appropriate body or authority (Institutional Conflicts Committee; Board Committee; Board)
- Reduce or mitigate the influence of the interest
- Change personnel, or duties and responsibilities of affected personnel
- Appoint an independent approver, reviewer and/or monitor
- Sever relationships with entities that are subject to conflict, if/as needed

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In the End . . .

- It's about the Public Relations
- Gut-check if it showed up on the front page of the newspaper

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